92-1958

No. 92-

Supreme Court, U.S.
FILED
JUN 9 1993
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IN THE
# Supreme Court of the United States
OCTOBER TERM, 1992

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DESARROLLOS METROPOLITANOS, INC.,
*Petitioner,*
v.
TABER PARTNERS I, a New York General Partnership, MERIT BUILDERS, INC., MERIT BUILDERS, S.E., and VICTOR TORRES & ASSOCIATES,
*Respondents.*

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**Petition for a Writ of Certiorari to the United States Court of Appeals for the First Circuit**

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## PETITION FOR A WRIT OF CERTIORARI

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## QUESTION PRESENTED

Whether a corporation's principal place of business for purposes of diversity jurisdiction, 28 U.S.C. § 1332(c), may be determined without reference to, and found to be other than, the place of the corporation's only physical operations, simply because those operations are conducted through a legally distinct entity such as a subsidiary or a partnership.

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**Petition for a Writ of Certiorari to the United States Court of Appeals for the First Circuit**

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## PETITION FOR A WRIT OF CERTIORARI

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Petitioner seeks review of the judgment of the United States Court of Appeals for the First Circuit in this case, holding that a corporation's principal place of business for purposes of diversity jurisdiction, 28 U.S.C. § 1332 (c), is to be determined without reference to the place of the corporation's only physical operations if those operations are conducted through a legally distinct entity, here a partnership.

## OPINIONS BELOW

The opinion of the court of appeals (App., *infra,* at 1a-16a) is reported at 987 F.2d 57. The opinion of the district court (App., *infra,* at 17a-34a) is reported at 798 F. Supp. 904.

## JURISDICTION

The judgment of the court of appeals was entered on March 3, 1993. App., *infra,* at 2a. Timely petitions for rehearing were denied on April 2, 1993. App., *infra,* at 35a-36a. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

## STATUTE INVOLVED

The statute granting the district courts jurisdiction based on diversity of citizenship, 28 U.S.C. § 1332, provides in pertinent part:

> (a) The district courts shall have original jurisdiction of all civil actions where the matter in controversy exceeds the sum or value of $50,000, exclusive of interest and costs, and is between—
>
> (1) citizens of different States; . . . .
>
> * * * *
>
> (c) For the purposes of this section and section 1441 of this title—
>
> (1) a corporation shall be deemed to be a citizen of any State by which it has been incorporated and of the State where it has its principal place of business . . . .
>
> * * * *
>
> (d) The word "States," as used in this section, includes the Territories, the District of Columbia, and the Commonwealth of Puerto Rico.

## STATEMENT

This case involves a construction-contract dispute over the renovation and expansion of the Ambassador Plaza Hotel & Casino in Puerto Rico. The plaintiff, respondent Taber Partners I, a partnership composed of two corporations, sued respondents Merit Builders, Inc., and Merit Builders, S.E., which are corporate citizens of Puerto Rico, invoking the district court's diversity jurisdiction, 28 U.S.C. § 1332. The district court dismissed the action

for lack of diversity because Taber is also a citizen of Puerto Rico. As required by *Carden v. Arkoma Assocs.*, 494 U.S. 185 (1990), the court looked to the citizenship of the two corporations that formed the partnership; and it concluded that those corporations had their "principal place of business" (and hence citizenship, 28 U.S.C. § 1332(c)) in Puerto Rico, where they conducted their only business operation, the hotel project. The court of appeals reversed, holding that the two underlying corporations' principal place of business must be determined without reference to the hotel project, because that operation was conducted through a legally distinct entity, the partnership.

1. *Background.* In December 1986, two corporations were formed in New York—Lerfer San Juan Corp. and Calumet Corp. App., *infra*, at 4a. The same month, the two corporations formed a partnership under New York law—respondent, Taber Partners I—with Lerfer San Juan holding a 99% ownership interest and Calumet a 1% interest. *Id.* at 5a-6a. Taber's express function was to purchase, renovate, and run the Ambassador Hotel in Puerto Rico: " 'The primary and specific purpose of the Partnership is to acquire, own, operate and manage [the Ambassador Hotel in San Juan].' " *Id.* at 6a (quoting Partnership Agreement § 4.01, C.A. Jt. App. A-336). Moreover, as the court of appeals explained, the Taber hotel project was the only business interest of both Lerfer San Juan and Calumet: "each corporation's sole function is to hold or administer its respective interest in Taber." App., *infra*, at 6a. *See also* C.A. Jt. App. A-327 (affidavit of Linda Romano, owner of Calumet and officer/director of Lerfer San Juan) ("The only business activities of Lerfer and Calumet are to administer or hold their interests in Taber."); C.A. Jt. App. A-139 to -140 (deposition of Eugene Romano, owner of Lerfer San Juan and officer/director of Calumet) (only operation and corporate purpose of Lerfer San Juan were acquisition and ownership of the hotel "through" Taber).

Lerfer San Juan and Calumet ensured their close control of the hotel project by delegating the day-to-day management of Taber to their individual owners: they named Eugene Romano, the sole owner of Lerfer San Juan, as Taber's executive director, and Linda Romano, the sole owner of Calumet, as Taber's assistant director. App., *infra*, at 6a; C.A. Jt. App. A-344 (§ 7.01 of Partnership Agreement). Lerfer San Juan also loaned substantial sums to Taber for the hotel project. App., *infra*, at 6a, 34a. And the Boards of Directors of both Lerfer San Juan and Calumet convened in Puerto Rico on two critical occasions: when authorizing the formation of Taber for the purchase of the hotel; and when raising the principal financing for the hotel project, a $27 million bond. App., *infra*, at 7a n.3, 28a n.6.[1]

Lerfer San Juan's and Calumet's ties to New York were different in kind from the foregoing operational activities in Puerto Rico. Their corporate headquarters (and sole office) were an office in Utica, New York (one that Eugene Romano used for his other business ventures, *see* C.A. Jt. App. A-141). Their corporate books and records were accordingly maintained there; their legal, auditing, and accounting work was handled in New York; they maintained their bank accounts, and Lerfer San Juan had a working capital account at an investment firm, in New York; and they filed their federal tax returns from New York and filed state income tax returns in New York (not in Puerto Rico). App., *infra*, at 5a. The annual meetings of the Boards of Directors, where policy decisions were made and officers and accountants were selected, were held in New York. *Id.* at 6a-7a; *but cf.* note 1, *supra* (2 of 6 board meetings held in Puerto Rico). And loans

[1] *See* C.A. Jt. App. A-329 (affidavit of Linda Romano): "Since their formation, the corporations have held six meetings of their respective boards of directors. Four regular meetings were held in New York. Two special meetings were held in San Juan in connection with the purchase of the hotel and the refinancing of the hotel."

made by Lerfer San Juan to Taber were arranged and executed in New York. *Id.* at 6a. In short, the organizational and financial management of Lerfer San Juan and Calumet occurred primarily in New York.

2. *District Court Proceedings.* Beginning in March 1988, Taber entered into a series of contracts with respondents Merit Builders, Inc., and Merit Builders, S.E. (together, "Merit"), for Merit to provide construction and other services for the renovation and expansion of the Ambassador Hotel in San Juan. By early 1991, disputes about the project had arisen. In February 1991, Taber sued Merit in federal district court in Puerto Rico, invoking diversity jurisdiction and alleging breach of contract and other causes of action. Merit, in addition to filing counterclaims against Taber, filed third-party complaints against two new parties: respondent Victor Torres & Associates, the inspecting architect on the project; and petitioner Desarrollos Metropolitanos, Inc., one of Merit's subcontractors. App., *infra* at 3a.[2]

It is not disputed that Merit, Victor Torres & Associates, and Desarrollos Metropolitanos all are citizens of Puerto Rico. App., *infra*, at 3a. Taber claimed diversity based on its allegation that its two partners, Lerfer San Juan and Calumet—whose citizenship determines the citizenship of the partnership, *Carden v. Arkoma Assocs., supra*—were both citizens of New York. Merit accepted Taber's alleged citizenship, but after most pre-trial proceedings were completed, Desarrollos Metropolitanos and Victor Torres contested jurisdiction. They relied on the 1958 amendment to the diversity statute, in which Congress provided that a corporation is a citizen, for diversity purposes, of *both* its State(s) of incorporation *and* its principal place of business. 28 U.S.C. § 1332(c). The third-party defendants argued that, although Lerfer San

[2] Pursuant to Rule 29.1 of the Rules of this Court, petitioner states that it has no parent companies and has no subsidiaries except wholly owned subsidiaries.

Juan and Calumet were incorporated in New York, their principal place of business was Puerto Rico—not, as Taber alleged, New York. *See* App., *infra,* at 3a-4a.[3]

The district court agreed that Lerfer San Juan and Calumet had their principal place of business in Puerto Rico and accordingly dismissed the case for lack of diversity. App., *infra,* at 17a-34a. The court applied the "total activities" test for determining a corporation's principal place of business, a test that considers both the "nerve center" of the corporation—the place from which " 'the activities of the corporation are controlled and directed' "—and the "center of corporate activities." App., *infra,* at 31a, 22a (quoting *Topp v. CompAir Inc.*, 814 F.2d 830, 834 (1st Cir. 1987)). In deciding what weight to give these factors, moreover, the district court followed the Fifth Circuit's guideline that " 'when a corporation has its sole operation in one state and executive offices in another, the place of activity is regarded as more significant.' " *Id.* at 32a-33a, 23a-24a (quoting *J.A. Olson Co. v. City of Winona,* 818 F.2d 401, 411 (5th Cir. 1987)). The court then readily found the place of Lerfer San Juan's and Calumet's activity to be Puerto Rico (App., *infra,* 33a-34a):

> the Court rejects the contention of Merit and Taber that Lerfer and Calumet are only engaged in passive investment activity. Only a unrealistically narrow view of the orientation of the corporations and their partnership could yield such a conclusion. The corporations were formed to act as owners of the Ambassador Plaza. They devote almost all of their corporate activity to administer their assets in the

[3] At the same time as it filed suit against Merit, Taber filed another diversity action against the issuer of the performance bond on the construction contract, Insurance Company of North America (INA), a citizen of neither New York nor Puerto Rico. That action was consolidated with Taber's suit against Merit. INA joined Merit's brief in the district court supporting jurisdiction but did not file its own notice of appeal or otherwise participate in the court of appeals.

partnership. They actively authorized the formation of Taber and the obtaining of a bond to assist in the financing of the projects. They have loaned substantial amounts of money to Taber. And the directors of the partnership, Mr. and Ms. Romano, are the directors of the corporations. Under these circumstances, the Court cannot accept the characterization of the corporations' interests in Taber as passive. The Court therefore considers of greater significance the location of the corporations' primary activity. This activity is the renovation and operation of the Ambassador Plaza, which is located in Puerto Rico.

3. *Court of Appeals Decision.* The court of appeals reversed. App., *infra*, at 1a-16a. The court stated the question before it as "whether, for purposes of diversity jurisdiction, a partnership's business activities should be considered in determining the principal place of business of each of its corporate partners." *Id.* at 2a. The court broadly held: "in the absence of evidence that the partnership and its corporate partners failed to maintain their separate identities, the partnership's activities ordinarily should not be considered for this purpose." *Ibid.*

In reaching this conclusion, the court relied entirely on its precedents involving the determination of a corporation's principal place of business where a parent-subsidiary relationship was present. App., *infra*, at 8a-12a. In that context, the court noted, it had "repeatedly held that, where there is no evidence that the integrity of the corporate form has been violated, the separate corporate identities of a parent and subsidiary should be honored when determining either one's principal place of business." *Id.* at 9a. That was so, moreover, even when the two entities were "closely intertwined," because the question is "not the degree of control the parent exercised over the subsidiary, but whether the two businesses preserved their separate corporate identities." *Id.* at 11a. Apparently acknowledging its disagreement with

at least the Fifth Circuit,[4] the court thus reaffirmed that, unless parent and subsidiary corporations have themselves ignored their separate formal identities, the inquiry into principal place of business "must focus *solely* on the business activities of the corporation whose principal place of business is at issue." *Id.* at 12a (emphasis in original).

The court concluded that this principle should "apply with equal force where the entities at issue are corporate partners." *Ibid.* (footnote omitted). The court rejected the suggestion that a partnership and partners are effectively indistinguishable under state partnership law. Citing this Court's decision in *Carden, supra,* the court stated: "*federal* law . . . distinguishes between a partnership and its partners for purposes of diversity jurisdiction." *Id.* at 13a n.5 (emphasis in original).

The court of appeals then applied its rule insisting on rigid separation of distinct legal entities—here, the corporations and their partnership—and held that Lerfer San Juan and Calumet had their principal place of business in New York, because the activities of their partnership, Taber, were to be ignored. App., *infra,* at 13a-14a. The court explained that "the sole corporate 'activities' of *Lerfer* and *Calumet* consists of holding or administering their assets in Taber, and . . . all such administering occurs exclusively in New York." *Id.* at 13a (emphasis added). Given that Lerfer San Juan and Calumet had delegated to others (their owners) the day-to-day manage-

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[4] After its lengthy citation of its own supporting precedent (and a few cases from other circuits), the court of appeals added the citation: "*Contra Freeman v. Northwest Acceptance Corp.*, 754 F.2d 553, 557 (5th Cir. 1985) (imputing citizenship of a subsidiary to its parent and alleged 'alter-ego') (citing *Toms v. Country Quality Meats, Inc.*, 610 F.2d 313, 315-16 (5th Cir. 1980)); *Bonar, Inc. v. Schottland,* 631 F. Supp. 990, 997-98 (E.D. Pa. 1986) (imputing citizenship of parent to subsidiary where evidence showed that the business of both was 'identical' and court determined that their formal separation was 'merely a corporate fiction')." App., *infra,* at 10a.

ment of the hotel project, the court reasoned that "there is no evidence that Lerfer and Calumet engage in the operation and/or management of the Hotel." *Ibid.* The court therefore held to be clearly erroneous the district court's finding that Lerfer San Juan and Calumet conducted their principal activities in Puerto Rico, a finding that the court of appeals faulted for failing to keep rigidly separate the *asset*-management activities of Lerfer San Juan and Calumet from the *hotel*-management activities of Taber, "a separate, and legally distinct, partnership entity." *Id.* at 13a, 14a. In short, the First Circuit concluded, as "holding companies" Lerfer San Juan and Calumet had no physical operations, but simply managed their investment in Taber from New York, making New York their principal place of business under either the "nerve center" or "center of corporate activity" test and thus creating diversity jurisdiction. *Id.* at 13a-14a.[5]

The court denied rehearing but stayed its mandate to allow the filing of a petition for a writ of certiorari on or before June 10, 1993.

## REASONS FOR GRANTING THE PETITION

The First Circuit in this case held that, in determining a corporation's principal place of business for purposes of diversity jurisdiction, a court must disregard any activities conducted through a distinct entity, such as a subsidiary or partnership, that maintains a separate legal identity. That ruling conflicts with the law at least in the Fifth Circuit. It is also incorrect—particularly as to corporations that conduct their business through partnerships —for it improperly expands diversity jurisdiction over essentially local disputes by ignoring the real place of business operations of corporations like Lerfer San Juan

[5] The court acknowledged, and tried to distinguish on their facts, "a line of cases in which district courts, in determining the principal place of business of a holding company, have looked to the business of the entity whose assets are being held rather than to the business of the holding company." *Id.* at 14a n.9.

and Calumet. This Court should resolve the conflict and adopt the Fifth Circuit's position, thereby providing consistency and clarity on a threshold jurisdictional issue that arises frequently in the federal courts. At the same time, the case presents an opportunity for the Court to bring welcome authoritative guidance to the lower courts grappling with how to decide which activities conducted on behalf of a corporation—its management and direction, its physical operations, its other activities—determine the corporation's principal place of business in various circumstances.

1. The First Circuit in this case applied a rigid rule requiring adherence to the formally maintained boundaries of legally distinct entities when considering the business activities that determine where a corporation has its principal place of business. Drawing that rule from its precedents broadly forbidding attribution to one corporation of activities formally conducted by another corporation (*e.g.*, a subsidiary), the court concluded that those precedents in fact established a generally applicable rule that a corporation's activities do not include activities conducted through any formally separated, legally distinct entity, such as a partnership. This rule and the precedents on which it is based—as the First Circuit itself appears to have recognized (*see* note 4, *supra*)—are contrary to the law at least in the Fifth Circuit.

The Fifth Circuit has repeatedly held that the inquiry into a corporation's principal place of business does not necessarily stop at the corporation itself but may extend to the business activities of distinct entities, such as separate corporations (even when not a parent or subsidiary), that have and maintain separate legal identities. *See Freeman v. Northwest Acceptance Corp.*, 754 F.2d 553, 556-59 (5th Cir. 1985); *Toms v. Country Quality Meats, Inc.*, 610 F.2d 313 (5th Cir. 1980); *see also Kuehne & Nagel v. Geosource, Inc.*, 874 F.2d 283 (5th Cir. 1989); *Panalpina Welttransport GMBH v. Geosource, Inc.*, 764 F.2d 352, 354-55 (5th Cir. 1985). The

Fifth Circuit explained that the courts should not "ignore the reality of th[e] situation" or "elevate form over substance" or indulge in "blind adherence to form and equally blind disregard of the facts." *Freeman*, 754 F.2d at 557, 558. Instead, in deciding whether to attribute to a corporation the business activities of another entity for purposes of determining the corporation's principal place of business—to deem one the "alter ego" of the other—the Fifth Circuit has said that it looks to the control of one by the other and its actual responsibility for the challenged conduct. *Id.* at 557. Other courts have applied a similar approach. *See Fritz v. American Home Shield Corp.*, 751 F.2d 1152, 1154 (11th Cir. 1985); *Bonar, Inc. v. Schottland*, 631 F. Supp. 990 (E.D. Pa. 1986); *Textron Electronics, Inc. v. Unholtz-Dickie Corp.*, 193 F. Supp. 456 (D. Conn. 1961). And the leading commentators have recognized this approach in the Fifth Circuit (and elsewhere). *See* 13B C. Wright, A. Miller, & E. Cooper, *Federal Practice and Procedure* § 3625, at 635-36 (1984 & Supp. 1992); 1 J. Moore, J. Lucas, H. Fink, R. Freer, D. Weckstein & J. Wicker, *Moore's Federal Practice* ¶ 0.77[2.—5], at 800.100-800.103 (2d ed. 1993).[6]

The First Circuit, by contrast, has stated that the boundaries of separate legal entities may be breached *only* when their separate formal identities have been ignored, *i.e.*, where "the integrity of the corporate form has been violated." App., *infra*, at 9a, 12a. The court specifically rejected the relevance of "degree of control" or other facts showing that the two entities are, as a practical

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[6] The Fifth Circuit has indicated that it will ignore formal legal boundaries only where doing so defeats rather than creates diversity jurisdiction, because Congress intended to limit diversity jurisdiction in enacting the "principal place of business" rule in 1958. *See J.A. Olson Co. v. City of Winona*, 818 F.2d 401, 413-14 (1987); *Panalpina*, 764 F.2d at 354. The present case, of course, is one in which the Fifth Circuit would apply its approach, because jurisdiction would thereby be defeated.

matter, "closely intertwined." *Id.* at 11a. And it repudiated the pragmatic "alter ego" doctrine of the Fifth Circuit in terms—both in its *"Contra"* citation of *Freeman,* followed by the parenthetical description of *Freeman*'s reliance on the "alter-ego" doctrine (App., *infra,* at 10a); and in its *"Accord"* citation of the District of Columbia Circuit's decision in *Pyramid Sec. Ltd. v. IB Resolution, Inc.,* 924 F.2d 1114, 1120, *cert. denied,* 112 S. Ct. 85 (1991), with the parenthetical description of the D.C. Circuit's recognition of the "separate corporate identity of parent despite evidence that parent was 'alter-ego' of its subsidiary and was being sued for acts of its subsidiary" (App., *infra,* at 9a).[7] There is, in short, a clear split of authority on the propriety of breaching formally respected boundaries of separate legal entities in determining a corporation's principal place of business.[8]

There can be no doubt that, in this case, the district court's finding of Puerto Rico as the principal place of business of Lerfer San Juan and Calumet would have been upheld in the Fifth Circuit. Indeed, application of the Fifth Circuit's "alter ego" rule to a partnership follows *a fortiori* from its application of that rule to separate corporations, because the partners—unlike the parent of a separate subsidiary—are always liable for the partner-

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[7] The First Circuit's parenthetical descriptions of the many cases cited on pages 9a-10a of its opinion make crystal clear that it is only " 'formal separation' " that counts for the First Circuit (App., *infra,* at 10a, quoting *Schwartz v. Electronic Data Sys., Inc.,* 913 F.2d 279, 283 (6th Cir. 1990)), even when one entity is closely controlled by and intertwined with another. See especially the descriptions (App., *infra,* at 9a) of *U.S.I. Properties Corp. v. M.D. Constr. Co.,* 860 F.2d 1 (1st Cir. 1988), *cert. denied,* 490 U.S. 1065 (1989); *Topp v. CompAir Inc., supra; de Walker v. Pueblo Int'l, Inc.,* 569 F.2d 1169 (1st Cir. 1978); and *Danjag, S.A. v. Pathe Communications Corp.,* 979 F.2d 772 (9th Cir. 1992).

[8] Like the First Circuit in this case, the D.C. Circuit has repudiated the Fifth Circuit's doctrine. In *Pyramid,* it expressly rejected the district court's reliance on *Freeman* in reversing a "principal place of business" finding. 924 F.2d at 1120.

ship's obligations. *See, e.g.*, H. Reuschlein & W. Gregory, *The Law of Agency and Partnership* § 182, at 264 (2d ed. 1990).[9] And on the facts of this case in particular, the activities of Taber clearly would be deemed the activities of Taber's two corporate partners, whose only business interest was the hotel project, whose individual owners were appointed to manage the partnership on a day-to-day basis, and which, by law, not only controlled but were liable for the decisions of the partnership. Moreover, those activities, the sole operational activities of Lerfer San Juan and Calumet, would clearly have determined the principal place of business as Puerto Rico under Fifth Circuit precedent, as the district court in this case found. *See* App., *infra*, at 23a, 32a-33a.

In short, the result of this case in the Fifth Circuit would have been directly contrary to the holding of the First Circuit. That conflict follows directly from a disagreement on a frequently recurring legal issue. *See* App., *infra*, at 9a-10a (citing numerous cases). The disagreement should be resolved by this Court.

2. Upon review, the First Circuit's rule refusing to look beyond formally respected boundaries of a separate corporation or partnership should be rejected. Even in the context of separate corporations, it is simply unrealistic to deny that the business of a parent includes any activities of the subsidiary for which the parent is legally responsible: in such a case, the relevant activities are every bit as much activities of, on behalf of, or by the parent as the subsidiary. In other words, the corporation is conducting such activities through its subsidiary. It is contrary to common sense to ignore those operations

[9] The reverse implication is not necessarily valid: a corporation's unique status as an independent legal entity for diversity-citizenship purposes (*Carden v. Arkoma Assocs., supra*) could conceivably be treated as entitled to rigid respect even if the boundaries of a partnership are not. But under the Fifth Circuit view that the courts may look through the form of even a corporation, there can be no ground for treating a partnership as sacrosanct.

in determining the corporation's "principal place of business" under 28 U.S.C. § 1332(c).[10]

Taking account of such activities also accords with the particular policies behind Section 1332(c), especially in a case where a corporation conducts all of its physical operations through a particular subsidiary in a particular State. The "principal place of business" test ties the concern with local prejudice that underlies diversity jurisdiction to a corporation's absence from the State; but if a parent corporation is responsible for the activities of its subsidiary in a State, it is as present for these purposes as the subsidiary, and therefore no more likely to suffer local prejudice than the subsidiary. At the same time, allowing breach of corporate boundaries fulfills Congress's purpose, when it enacted the "principal place of business" test in 1958, of reducing diversity jurisdiction: litigation is most likely to arise where physical operations take place and to involve local citizens; attributing those operations to a parent corporation makes local citizenship of the parent more likely, thus defeating diversity. Even more specifically, Congress's borrowing of the "principal place of business" test from bankruptcy law supports the Fifth Circuit position, because "[i]nclusion of a subsidiary's business as a part of the business of the parent corporation for the purpose of locating the parent's 'principal place of business' [was] no innovation as far as the Bankruptcy Act [was] concerned." *Textron Electronics, Inc.*, 193 F. Supp. at 459. *See J.A. Olson Co.*, 818 F.2d at

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[10] As Chief Judge Merritt observed in *Schwartz v. Electronic Data Sys., Inc.*, 913 F.2d at 286-94 (Merritt, C.J., dissenting), the usual common-law doctrine of corporate law treating parents and subsidiaries as separate for purposes of liability should not be blindly transferred to the context of diversity jurisdiction, and where justification for such a borrowing is lacking, the doctrine should not be applied. Of course, even corporate law allows piercing of the corporate veil in appropriate circumstances. *Id.* at 290. And, as noted below, a doctrine of corporate law based on the principle of limited liability should have no application in any event to partnership law, which rejects that principle.

404-06; *cf.* C. Wright, A. Miller, & E Cooper, *supra,* at 632.

When the separate entity is a partnership, as it is in this case, the error of the First Circuit's refusal to look beyond formal boundaries is particularly stark. Under the New York law that governs the partnership in this case, and under partnership law generally, a defining characteristic of a partnership is the *absence* of a meaningful separation of the partners and the partnership: notably, the partners themselves are co-owners of all partnership property, and they are directly liable for the debts and torts of the partnership, which itself is bound by each partner's acts carrying on its business. *See* N.Y. Partnership Law § 51 (property ownership), § 20 (partnership liability), § 26 (partner liability) (McKinney's 1988); Uniform Partnership Act §§ 9, 15, 25 (1919); H. Reuschlein & W. Gregory, *supra,* § 2, at 6 ("partners are agents and also principals for each other"); *Meehan v. Valentine,* 145 U.S. 611 (1892). In brief, the partnership's activities are, by law, *always* activities of the partners.[11]

Indeed, any other conclusion flies in the face of this Court's decision in *Carden, supra,* which establishes precisely the opposite of the First Circuit's assertion, citing *Carden,* that "federal law . . . distinguishes between a partnership and its partners for purpose of diversity jurisdiction." App., *infra,* at 13a n.5 (emphasis omitted). This Court in *Carden* held that a partnership, for purposes of diversity of citizenship under 28 U.S.C. § 1332, is *not* to be distinguished from its partners, but instead

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[11] That is so, contrary to the First Circuit's apparent understanding, even when the partners have "delegated" some of their managerial responsibilities (App., *infra,* at 13a). A "delegation" merely creates an agency relationship, leaving the principal (here, the partners) still fully responsible for the authorized acts carried out by the delegate. *See* Restatement (Second) of Agency § 140 *et seq.* (1959).

takes its citizenship from the citizenship of its partners. 110 S. Ct. at 1017-22. In this case, therefore, the First Circuit, in determining diversity of citizenship, properly ignored Taber as a separate entity and looked straight through it to its partners, Lerfer San Juan and Calumet. But having followed *Carden*'s command in that respect—refusing to treat the partnership for these purposes as a legal entity in its own right, separate and apart from its partners—the First Court then violated *Carden*'s command by turning around and insisting on rigid respect for the partnership as a separate legal entity when determining the place of Lerfer San Juan's and Calumet's activities. That ruling is inconsistent with *Carden*'s holding that the diversity statute disregards any distinction between a partnership and its partners.

3. Granting review in this case would allow the Court not only to resolve the conflict over whether consideration of a corporation's activities may look past the boundaries of a formally separate legal entity such as a subsidiary or partnership. The case also presents an opportunity for the Court to clarify which activities of a corporation determine its principal place of business. Such clarification would assist the lower courts in their frequent task of assessing diversity jurisdiction in cases involving corporations.

As the court of appeals in this case observed, the lower federal courts have developed " 'three distinct, but not necessarily inconsistent tests' for determining a corporation's principal place of business: (1) the 'nerve center' test, which searches for the location from which the corporation's activities are controlled and directed; (2) the 'center of corporate activity' test, which searches for the location of the corporation's day-to-day management; and (3) the 'locus of the operations of the corporation' test, which searches for the location of the corporation's actual physical operations." App., *infra*, at 8a (quoting *Topp v. CompAir Inc.*, 814 F.2d at 834). *See also Moore's*

*Federal Practice* ¶ 0.77[3.—1], at 800.105 ("Courts have not always agreed on what factors to consider in determining a corporation's principal place of business. The basic conflict has been over whether to concentrate on the situs of the entity's actual operations or to look to its 'nerve center,' the place from which those operations are directed and controlled."); C. Wright, A. Miller, & E. Cooper, *supra,* § 3625, at 620-21; *Village Fair Shopping Ctr. Co. v. Sam Broadhead Trust,* 588 F.2d 431, 433-34 (5th Cir. 1979) ("total activity" test incorporating "nerve center" and "place of activity" test).

These tests, as the First Circuit noted, are "not necessarily inconsistent." Given the recurrent nature of the problem, various commentators and lower courts have undertaken to formulate guidelines designed to reconcile the cases applying these various tests, making one or the other dispositive depending on the type of corporation. They have generally identified the locus of actual operations as dispositive, unless a corporation has such far-flung activities, so widely and evenly distributed among various States, that the statutory necessity of identifying a single "principal" place of business demands selection of the corporation's executive offices. They have explained, moreover, that this approach best accords with Congress's intent in adding the "principal place of business" test to the diversity statute in 1958, including its intent to reduce the number of diversity cases. *See, e.g., Moore's Federal Practice* ¶ 0.77[3.—4], at 800.114-800.122; C. Wright, A. Miller, & E. Cooper, *supra,* at 625-32; *J.A. Olson Co.,* 818 F.2d at 411 (*quoted in* district court opinion at App., *infra,* at 23a-24a).

The present case presents an opportunity for this Court to consider, and adopt, this simplified and sensible approach to determining corporate citizenship if the Court concludes, as it should, that Taber's hotel activities are properly considered activities of its corporate partners. (Those activities would, as the district court found, then

determine the partners' principal place of business as Puerto Rico and defeat diversity.) Such an authoritative pronouncement of this Court would save precious judicial time, and eliminate uncertainty, in the many courts that have not yet decided which test applies in which circumstances and in courts, like the Seventh Circuit, that have seemingly adopted a different approach. *See Buethe v. Britt Airlines, Inc.*, 787 F.2d 1194 (7th Cir. 1986); *Moore's Federal Practice* ¶ 0.77[3.—4], at 800.115-800.116. This case is thus a particularly good vehicle for the Court to bring clarity and consistency to several aspects of the recurrent problem of determining a corporation's principal place of business for purposes of diversity jurisdiction.

## CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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Dated: June 9, 1993

# APPENDICES

**APPENDIX A**

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

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No. 92-1921

TABER PARTNERS, I,
A NEW YORK GENERAL PARTNERSHIP,
*Plaintiff, Appellant,*

v.

MERIT BUILDERS, INC., A PUERTO RICO CORP., *et al.*,
*Defendants, Appellees.*

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No. 92-1922

TABER PARTNERS, I,
A NEW YORK GENERAL PARTNERSHIP,
*Plaintiff, Appellee,*

v.

MERIT BUILDERS, INC., A PUERTO RICO CORP.,
*Defendant, Appellant.*

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Appeals from the United States District Court
for the District of Puerto Rico
[Hon. Jaime Pieras, Jr., *U.S. District Judge*]

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Before

Selya, *Circuit Judge*,
Coffin, *Senior Circuit Judge*, and
Stahl, *Circuit Judge*.

*Harvey B. Nachman* with whom *Joan Schlump Peters* was on brief for Merit Builders, Inc. and *Arch Stokes* with whom *John R. Hunt, Stokes and Murphy, Ruben T. Nigaglioni* and *Ledsma, Palou & Miranda* were on brief for Taber Partners I.

*Jay A. Garcia-Gregory* with whom *Rafael R. Vizcarrondo, Humberto Guzman-Rodriguez* and *Fiddler, Gonzalez & Rodriguez* were on brief for appellees.

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March 3, 1993

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STAHL, *Circuit Judge*. This appeal requires us to decide whether, for purposes of diversity jurisdiction, a partnership's business activities should be considered in determining the principal place of business of each of its corporate partners. We hold that, in the absence of evidence that the partnership and its corporate partners failed to maintain their separate identities, the partnership's activities ordinarily should not be considered for this purpose.

I.

PROCEDURAL POSTURE

Plaintiff Taber Partners I ("Taber"), a New York general partnership whose sole partners are two New York corporations, Lerfer San Juan Corp. ("Lerfer"), and Calumet Corp. ("Calumet"), owns and operates the Am-

bassador Plaza Hotel & Casino ("Hotel") in San Juan, Puerto Rico. Defendants Merit Builders, Inc. and Merit Builders, S.E. (hereinafter referred to collectively as "Merit") are Puerto Rico-based construction companies. Beginning in March 1988, Taber and Merit entered into a series of consulting and construction contracts involving the renovation and expansion of the Hotel. Disputes arose during the course of the project, and in February 1991, Taber commenced a diversity action against Merit in the United States District Court for the District of Puerto Rico asserting, *inter alia,* breach of contract, fraud, and negligence. Merit responded with several counterclaims against Taber and filed third-party complaints against appellees Victor Torres & Associates ("VTA"), the inspecting architect, and Desarrollos Metropolitanos, Inc. ("Desarrollos"), one of the project subcontractors. Like Merit, both VTA and Desarrollos are citizens of Puerto Rico.

On the eve of trial, VTA and Desarrollos moved to dismiss, asserting that—because Taber was also a citizen of Puerto Rico—diversity of citizenship was lacking. As the citizenship of Taber depends upon the citizenship of its partners, Lerfer and Calumet, the district court first had to determine Lerfer's and Calumet's citizenship. *See Carden* v. *Arkoma Assocs.,* 494 U.S. 185, 195-96 (1990) (reaffirming the "oft-repeated rule that diversity jurisdiction in a suit by or against [a parnership] depends on the citizenship of 'all the [partners]' . . .") (quoting *Chapman* v. *Barney,* 129 U.S. 677, 682 (1889)). As Lerfer and Calumet are both incorporated in New York, the sole issue before the district court was the principal place of business of both corporations. *See* 28 U.S.C. § 1332(c)(1) ("For the purposes of [diversity,] . . . a corporation shall be deemed to be a citizen of any [s]tate by which it has been incorporated *and* of the [s]tate where it has its principal place of business") (emphasis supplied). The district court ultimately agreed with VTA's and Desar-

rollos' argument that the principal place of business of both Lerfer and Calumet was Puerto Rico. Thus, on July 8, 1992, the district court granted their motion and dismissed the case for lack of subject matter jurisdiction. *See Taber Partners I* v. *Insurance Co. of North America, Inc.*, 798 F. Supp. 904, 912 (D.P.R. 1992).

In this appeal, Taber and Merit, adversaries below, mount a joint challenge to the district court's dismissal of their case. In so doing, they argue that, in light of the undisputed evidence that Lerfer's and Calumet's corporate activities occurred almost exclusively in New York, the district court's selection of Puerto Rico as the principal place of business of both corporations is clearly erroneous. Before addressing appellants' argument, we sketch the relevant facts.

## II.

## FACTUAL BACKGROUND

In December 1986, Mr. F. Eugene Romano and Ms. Linda E. Romano, citizens of New York, incorporated Lerfer and Calumet in New York. At all relevant times,[1] Eugene Romano owned all the outstanding shares of Lerfer, and Linda Romano owned all the outstanding shares of Calumet. Linda Romano and Mrs. Jeanne Romano served as the officers of Lerfer, while Eugene Romano and Jeanne Romano served as the officers of Calumet. The same three individuals also served as the directors of both corporations.

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[1] For purposes of diversity jurisdiction, citizenship is determined as of the date of the initiation of the lawsuit. *See, e.g., Freeport-McMoRan, Inc.* v. *K N Energy, Inc.*, 111 S. Ct. 858, 859 (1991); *Media Duplication Servs., Ltd.* v. *HDG Software, Inc.*, 928 F.2d 1228, 1236 (1st Cir. 1991). Thus, we recite relevant facts as they existed on February 15, 1991, the date Taber filed its complaint.

Lerfer and Calumet are "Subchapter S" corporations, a status entitling them to favorable tax treatment under both federal law, *see generally* 26 U.S.C. § 1361 *et seq.*, and state law. *See generally New York Tax Law* § 660 (a) (McKinney 1987). *See also Taber Partners I*, 798 F. Supp. at 907-09 (explaining the legal and practical underpinnings of an "S Corporation"). The Certificates of Incorporation of both companies contain a broad declaration of corporate purpose "to engage in any lawful acts or activities for which corporations may be organized under the Business Corporation Law of the State of New York . . . ."

The headquarters (and sole office) of both corporations is located at 501 Main Street, Utica, New York. All corporate books and records are maintained at the headquarters, and all accounting, auditing, and legal work is handled for both corporations in the state of New York by New York accountants and attorneys. Both corporations maintain their bank accounts in New York, and Lerfer also maintains a working capital account with an investment firm in New York. Each files federal income tax returns from New York and state income tax returns in New York. Neither files income tax returns in Puerto Rico.

On December 29, 1986, shortly after their incorporation, Lerfer and Calumet entered into a partnership agreement ("the Agreement") that formed Taber. The Agreement lists New York, or "such other place or places as the [p]artners may determine[,]" as Taber's principal place of business.[2] Under the Agreement, Lerfer obtained a 99% ownership interest in Taber, and Calumet ob-

[2] While the Agreement was negotiated, drafted, and recorded in New York, it was "protocolized" in Puerto Rico for the purpose of recording the deed to the Hotel at the Registry of Property in San Juan. The protocol procedure was necessary to establish Taber's authority to own property under Puerto Rico law. *See* P.R. Laws Ann. tit. 31, § 4313 (1991).

tained a 1% ownership interest. Lerfer and Calumet agreed to share in Taber's net profits and losses under a formula which mirrored their respective ownership interests.

Article IV of the Agreement states: "The primary and specific purpose of [Taber] is to acquire, own, operate and manage [the Hotel in Puerto Rico]." Pursuant to section 7.01 of the Agreement, Lerfer and Calumet delegated the day-to-day management of Taber to Eugene Romano, as executive director, and Linda Romano, as assistant director. All responsibilities not enumerated in section 7.01 were delegated to the partnership generally. The Agreement specifically granted Taber the authority, *inter alia,* to borrow money, enter into contracts, bring and defend legal actions, and "[d]o any and all other acts and things necessary or proper in furtherance of the [p]artnership business."

Since their incorporation in 1986, Lerfer and Calumet have both described themselves on their federal and state tax returns as "holding compan[ies]." Eugene and Linda Romano testified in their depositions that each corporation's sole function is to hold or administer its respective interest in Taber. To this end, Lerfer and Calumet employ a "control-group" of twelve individuals to maintain their corporate records and financial accounts. All such maintenance occurs exclusively in New York. An example of the type of New York-centered activity in which Lerfer and Calumet engage is their management of loan transactions designed to secure their ownership interests in Taber. For instance, Eugene Romano has made substantial loans (totalling approximately $8,000,000) to Lerfer, which, in turn, reloaned these funds to Taber. Each of these loans consisted of funds that originated in New York and were evidenced by promissory notes prepared, executed, and delivered in New York.

The record reveals that all policy decisions for Lerfer and Calumet are made in New York. For example, the

decision to invest in Taber was made in New York. The election of corporate officers and the appointment of accountants occur at the annual Board of Directors meetings held in New York. Indeed, the record contains almost no evidence of corporate activity on the part of either Lerfer or Calumet taking place outside of New York.[3]

Despite these uncontroverted facts, the district court concluded that the principal place of business of both Lerfer and Calumet was Puerto Rico. In so doing, the court rejected appellants' characterization of Lerfer and Calumet as "passive" holding companies and found that their *raison d'etre* included the operation of the Hotel:

> Only a[n] unrealistically narrow view of the orientation of the corporations and their partnership could yield such a conclusion. The corporations were formed to act as owners of the [Hotel]. They devote almost all of their corporate activity to administer their assets in the partnership. They actively authorized the formation of Taber and the obtaining of a bond to assist in the financing of the projects. They have loaned substantial amounts of money to Taber. And the directors of the partnership, Mr. and Ms. Romano, are the directors of the corporations. Under these circumstances, the Court cannot accept the characterization of the corporations' interests in Taber as passive. The Court therefore considers of greater significance the location of the corporations' primary activity. This activity is the renovation and operation of the [Hotel], which is located in Puerto Rico.

*Taber Partners I*, 798 F. Supp. at 912. We do not concur in the district court's analysis.

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[3] The record reveals that Lerfer's and Calumet's Boards of Directors held two "special meetings" in San Juan, Puerto Rico, in connection with the initial purchase and subsequent refinancing of the Hotel.

## III.

## DISCUSSION

A district court's determination of citizenship for purposes of diversity jurisdiction is a mixed question of law and fact. As such, we will not set aside the district court's decision unless it is "clearly erroneous." *Lundquist* v. *Precision Valley Aviation, Inc.*, 946 F.2d 8, 11 (1st Cir. 1991); *Media Duplication*, 928 F.2d at 1237. In addition, we review the facts of this case mindful that the party invoking the jurisdiction of a federal court carries the burden of proving its existence. *See, e.g., Lundquist*, 946 F.2d at 10.

In this circuit, we utilize "three distinct, but not necessarily inconsistent tests" for determining a corporation's principal place of business: (1) the "nerve center" test, which searches for the location from which the corporation's activities are controlled and directed; (2) the "center of corporate activity" test, which searches for the location of the corporation's day-to-day management; and (3) the "locus of the operations of the corporation" test, which searches for the location of the corporation's actual physical operations. *Topp* v. *CompAir Inc.*, 814 F.2d 830, 834 (1st Cir. 1987).

While we have not had occasion to apply these tests to a general partnership whose partners are corporations, we frequently have applied them to corporations involved in parent-subsidiary relationship. *See, e.g., U.S.I. Properties Corp.* v. *M.D. Constr. Co., Inc.*, 860 F.2d 1, 7 (1st Cir. 1988), *cert. denied*, 490 U.S. 1065 (1989); *Rodriguez* v. *SK & F Co.*, 833 F.2d 8, 9 (1st Cir. 1987); *Topp*, 814 F.2d at 833-39; *Lugo-Vina* v. *Pueblo Int'l, Inc.*, 574 F.2d 41, 43-44 (1st Cir. 1978); *de Walker* v. *Pueblo Int'l, Inc.*, 569 F.2d 1169, 1170-73 (1st Cir.

1978). In this context, we have repeatedly held that, where there is no evidence that the integrity of the corporate form has been violated, the separate corporate identities of a parent and subsidiary should be honored when determining either one's principal place of business. *See U.S.I. Properties,* 860 F.2d at 7 (recognizing separate corporate identity of subsidiary despite evidence that subsidiary was wholly-owned by "grandparent" corporation, shared all its officers and directors with grandparent, was grossly undercapitalized, and did not prepare its own budget, construction requirements, or policies and procedures); *Rodriguez,* 833 F.2d at 9 (recognizing separate corporate identity of subsidiary where evidence showed that it operated independently from its parent); *Topp,* 814 F.2d at 833 (recognizing separate corporate identity of subsidiary holding company despite evidence that it could not act without the express permission of its parent, and that its sole function was to serve as financial conduit for parent); *Lugo-Vina,* 574 F.2d at 43 (recognizing separate corporate identity of parent where evidence showed it operated independently of wholly-owned subsidiary); *de Walker,* 569 F.2d at 1173 (recognizing separate corporate identity of parent despite evidence that parent consolidated its profits and losses with that of its wholly-owned subsidiary in presenting parent's financial reports to shareholders, that subsidiary was considered a "division" of parent, and that subsidiary accounted for 60% of parent's and subsidiary's combined operations). *Accord Danjag, S.A.* v. *Pathe Communications Corp.,* 979 F.2d 772, 774-75 (9th Cir. 1992) (recognizing separate corporate identity of parent despite evidence that subsidiary "perform[ed] the lion's share" of the film production for the parent) (citing *Lugo-Vina,* 574 F.2d at 43-44); *Pyramid Securities Ltd.* v. *IB Resolution, Inc.,* 924 F.2d 1114, 1120 (D.C. Cir.) (recognizing separate corporate identity of parent despite evidence that parent was "alter-ego" of its subsidiary and was being sued for acts of its subsidiary) (citing *U.S.I. Properties Corp.,*

860 F.2d at 7), *cert. denied*, 112 S. Ct. 85 (1991); *Schwartz* v. *Electronic Data Sys., Inc.*, 913 F.2d 279, 283 (6th Cir. 1990) (recognizing separate corporate identity of subsidiary where evidence showed "formal separation [was] maintained") (citing *U.S.I. Properties Corp.*, 860 F.2d at 7; *Topp*, 814 F.2d at 835). *Contra Freeman* v. *Northwest Acceptance Corp.*, 754 F.2d 553, 557 (5th Cir. 1985) (imputing citizenship of a subsidiary to its parent and alleged "alter-ego") (citing *Toms* v. *Country Quality Meats, Inc.*, 610 F.2d 313, 315-16 (5th Cir. 1980)); *Bonar, Inc.* v. *Schottland*, 631 F. Supp. 990, 997-98 (E.D. Pa. 1986) (imputing citizenship of parent to subsidiary where evidence showed that the business of both was "identical" and court determined that their formal separation was "merely a corporate fiction").

For instance, in *Topp*, we held that the district court erred in applying the "nerve center" test in a manner which "ignore[d] the separate corporate identity of the corporation whose citizenship [was] being sought." *Topp*, 814 F.2d at 835. In that case, the district court determined that the principal place of business of the subsidiary was England, the location of the parent. *Id.* at 832. The subsidiary in *Topp* was a holding company with no manufacturing, purchasing, or sales facilities. *Id.* at 834 n.3. Its principal function was to act as a financial conduit for its parent, providing administrative and financial services to various other subsidiaries across the United States. *Id.* at 834. The district court found that, although the subsidiary maintained an office and conducted its business activities in New Hampshire, it was controlled by the parent who made all of the major policy decisions, including the hiring and firing of the employees of the subsidiary. As a result, the district court reasoned that England was the subsidiary's "nerve center." *Id.* at 832.

We reversed the district court and held that it erroneously merged the activities of the subsidiary and the parent in determining the subsidiary's "nerve center." *Id.*

at 834. We made clear that, in determining a corporation's principal place of business, the activities of the company whose citizenship is at issue are those that are relevant. *Id.* Moreover, we held that as long as the corporate formalities are preserved by the parent and subsidiary, they are entitled to recognition:

> [D]efendants presented uncontradicted evidence that [the subsidiary] maintained, in New Hampshire, its own general ledger, corporate minutes book and register of unissued stock, its own bank accounts, and its own executive offices. [The subsidiary] filed its own federal and state income and unemployment taxes, social security contributions and excise taxes. This evidence indicates that the separate corporate identity of [the subsidiary] is entitled to be recognized.

*Id.* at 837. We therefore concluded that, while "the shots" may have been called by the parent in England, the principal place of business of the subsidiary was New Hampshire, the "operational center of the corporation in question." *Id.* at 835 n.4.

Likewise, in *de Walker,* we held that a parent's principal place of business was Puerto Rico, the situs of *its* "day-to-day management and operations," rather than New York, the place where its wholly-owned subsidiary conducted business. *de Walker,* 569 F.2d at 1172. Despite compelling evidence that the parent and subsidiary in *de Walker* were closely intertwined, *see id.* at 1171, we were not persuaded to ignore their separate corporate identities. *Id.* at 1172.

The critical factual question in *de Walker,* as in *Topp,* was not the degree of control the parent exercised over the subsidiary, but whether the two businesses preserved their separate corporate identities. We reasoned that:

> While the documents . . . indicate that [the parent] was ultimately the sole beneficiary and director of

> [the subsidiary's] corporate activities, there is nothing in the record to undermine [the parent's] claim that the two corporations were separately incorporated, had separate boards of directors, kept separate accounting and tax records, and had separate facilities and operational personnel. And, leaving aside the activities of [the subsidiary in New York], there is next to nothing in the record to establish that [the parent], *in its corporate capacity*, conducted any business outside Puerto Rico.

*de Walker*, 569 F.2d at 1171 (emphasis supplied). We further reasoned that the close interrelationship of the corporations was incidental to the parent's ownership of 100% of the subsidiary's stock and did "not justify ignoring the otherwise separate character of the two corporations." [4] *Id.* at 1173.

Thus, pertinent circuit authority, particularly our opinions in *Topp* and *de Walker*, stand for the following two unremarkable propositions: (1) that in determining a corporation's principal place of business, a district court's inquiry must focus *solely* on the business activities of the corporation whose principal place of business is at issue; and (2) that an excepton to this general rule applies where there is evidence that the separate corporate identities of a parent and subsidiary have been ignored. We can discern no reason why these propositions should not apply with equal force where the entities at issue are corporate partners.[5]

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[4] An exception to this general rule exists in cases where there is evidence that the parent and subsidiary have violated the integrity of the corporate formalities which they selected. *E.g.*, *de Walker*, 569 F.2d at 1173.

[5] The appellees attempt to justify the district court's treatment of Taber, Lerfer, and Calumet as one entity for diversity purposes by relying almost exclusively upon New York partnership law, which they contend regards the partners and a partnership as a single entity. Whether or not appellees are correct in their characterization of New York partnership law, a proposition on which

Here, the uncontroverted facts reveal that the sole corporate "activities" of Lerfer and Calumet consists of holding or administering their assets in Taber, and that all such administering occurs exclusively in New York. Moreover, there is no evidence that Lerfer and Calumet engage in the operation and/or management of the Hotel. Indeed, it is uncontroverted that Taber was expressly created by Lerfer and Calumet, as stated in the Agreement, "to acquire, own, operate and manage [the Hotel in Puerto Rico]." *See also* 798 F. Supp. at 905, 906 (characterizing as undisputed the fact that "Taber's business is the operation and management of the [Hotel]"). It is also apparent from the Agreement that Lerfer and Calumet delegated the day-to-day management of Taber to Taber's officers, Eugene and Linda Romano. Appellees have introduced no evidence to suggest that either Lerfer or Calumet ever usurped that role.[6]

In sum, the record reveals that Lerfer and Calumet serve as holding companies which manage their assets in Taber, a separate, and legally distinct, partnership entity, and that all their "activities" as holding companies occur exclusively in New York. We need go no further. Under either the "nerve center" test or the "center of corporate

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we express no opinion, such law is not controlling in light of *federal* law which distinguishes between a partnership and its partners for purposes of diversity jurisdiction. *See, e.g., Carden,* 494 U.S. at 195-96. We therefore find appellees' argument unpersuasive.

[6] We are aware that the district court found that Lerfer's and Calumet's "primary activity . . . is the renovation and operation of the [Hotel], which is located in Puerto Rico." *See Taber Partners I,* 798 F. Supp. at 912. However, we have not found any evidence to support such a finding. Indeed, the district court itself found that "[Lerfer and Calumet] devote almost all of their corporate activity to administer their assets in the partnership," *id.,* activity which occurs almost exclusively in New York. It further found that "Taber's business is the operation and management of the [Hotel]." *Id.* at 906. Given that the district court made no attempt to reconcile these findings, we are not inclined to accord them any deference.

activity" test,[7] the principal place of business of both Lerfer and Calumet is New York.[8] *Cf. Vareka Inves., N.V.* v. *American Inv. Properties, Inc.*, 724 F.2d 907, 910 (11th Cir.) (holding that Ecuador corporation which served as "passive investment vehicle" for Florida real estate venture had principal place of business in Ecuador where it maintained its corporate books and records, made all corporate decisions, held all corporate meetings, hired its employees, and obtained loans for the initial purchase of the venture), *cert. denied*, 469 U.S. 826 (1984).[9] Both Lerfer and Calumet are therefore citizens

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[7] Because Lerfer and Calumet have no physical operations (*i.e.*, factories, warehouses, sales offices, etc.) the "locus of the operations of the corporation" test would not be helpful. *See Topp*, 814 F.2d at 834 n.3 (rejecting utility of a "locus of physical operations of the corporation" test for a holding company).

[8] Because we find that New York is the principal place of business of both Lerfer and Calumet under either the "nerve center" or "center of corporate activity" test, we need not determine which of the two tests is most appropriate under these facts.

[9] In so holding, we are not unaware of a line of cases in which district courts, in determining the principal place of business of a holding company, have looked to the business of the entity whose assets are being held rather than to the business of the holding company. *See Bonar*, 631 F. Supp. at 996 ("[the holding company] was created to hold and operate [parent's] interest in [Pennsylvania company], and it has no business other than this venture. Therefore, [the holding company's] principal place of business is clearly Pennsylvania, not the state in which its executive and administrative offices may be located . . . ."); *Hanna Mining Co.* v. *Minnesota Power & Light Co.*, 573 F. Supp. 1395, 1400 (D. Minn. 1983) ("[The holding company] was created to hold and operate [parent's] interest in [Minnesota venture], and it has no business other than this venture. Therefore, [the holding company's] principal place of business is clearly in Minnesota, not in the state in which its executive and administrative offices may be located . . . ."), *aff'd*, 739 F.2d 1368 (8th Cir. 1984); *Hereth* v. *Jones*, 544 F. Supp. 111, 112 (E.D. Va. 1982) ("[The holding company's] sole *raison d'etre* is to be the corporate general partner in [a] Virginia nursing home venture. Thus[,] such activity as

of New York. And because a partnership is a citizen of those states in which its partners are citizens, *see supra* p. 3, it follows that Taber is also a citizen of New York, and that the district court's contrary determination was clearly erroneous.

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exists in Virginia is greater than the non-activity in any other [s]tate.").

While we were unable to discern from the facts of *Hanna Mining* exactly what level of activity took place in the state where the holding company's offices were located, the facts of both *Bonar* and *Hereth* reveal that the holding companies at issue in each case performed *no* corporate activity of any kind in the states where their offices were located. Indeed, in *Bonar*, the evidence revealed that the "office" was merely a mailing address, and that the company had no employees, executives, officers, or directors in the state where the "office" was located. *Bonar*, 631 F. Supp. at 994-95. As a result, the court was persuaded to look to Minnesota, where the holding company's attorney resided and worked, where its officers and directors resided, and where the negotiations over the initial stock purchase occurred. *Id.* at 995. Likewise, in *Hereth*, the court found that the holding company had "absolutely no function or activity" in the state of incorporation, and had "no employees anywhere." *Hereth*, 544 F. Supp. at 112. As a result, the court looked to the activities of the business venture that was owned by the partnership in which the holding company was a general partner. *Id.*

The instant case, however, presents an entirely different fact pattern. As detailed above, Lerfer and Calumet *operate* out of New York. They have an office, employees, bank accounts, a working capital account, corporate books and records, and Board of Directors meetings in New York. The corporate officers and directors all reside in New York, and almost all of the corporations' decisions are made in New York. As such, Lerfer and Calumet, unlike the holding companies at issue in *Bonar* and *Hereth*, are holding companies with corporate operations distinct from those of the company whose assets they hold. As a result, we find the reasoning in the above line of cases inapposite.

## IV. CONCLUSION

As Taber is a citizen of New York, the amount in controversy is ample, and none of the entities on the other side of the lawsuit shares Taber's citizenship, subject matter jurisdiction is present. We therefore reverse and remand the case for further proceedings consistent with this opinion.

*Reversed and remanded.*

**APPENDIX B**

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF PUERTO RICO

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Civil No. 91-1220 (JP)

TABER PARTNERS I,

vs. *Plaintiff*

INSURANCE COMPANY OF NORTH AMERICA, INC.,

and *Defendant*

MERIT BUILDERS, INC.,
*Defendant, Counterclaimant, and Third-Party Plaintiff*

vs.

VICTOR TORRES & ASSOCIATES

and

DESARROLLOS METROPOLITANOS, INC.,
*Third-Party Defendants*

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OPINION AND ORDER

[Filed July 8, 1992]

The Court has before it the Motion to Dismiss filed by third-party defendant Desarrollos Metropolitanos, Inc. (hereinafter "Desarrollos") on March 12, 1992, and the supplemental Motion to Dismiss filed by third-party defendant Victor Torres and Associates ("VTA") on April 1, 1992. For the reasons set forth below, the motions are hereby GRANTED.

I. Factual and Procedural Background

Plaintiff Taber Partners I ("Taber") is a New York General Partnership whose only partners are two Subchapter S corporations incorporated in New York—Lerfer San Juan Corporation ("Lerfer"), which holds a ninety nine percent (99%) interest in Taber, and Calumet Corporation ("Calumet"), which holds a one percent (1%) interest in Taber. Taber is the owner and operator of the Ambassador Plaza Hotel & Casino ("Ambassador Plaza") in Condado, Santurce, Puerto Rico. Defendant Merit Builders, Inc ("Merit") is a corporation organized and existing under the laws of Puerto Rico. Beginning in January 1989, Taber and Merit entered into a series of construction contracts for renovations and expansion of the Ambassador Plaza. Taber brought this action seeking recovery of damages caused by alleged delays, substandard workmanship, and loss of profits resulting from alleged breaches of contract, fraud, and negligence by Merit. Merit filed a counterclaim which seeks recovery on the contracts and for the alleged destruction of its ability to operate in the marketplace. The jurisdiction of this Court is predicated on diversity of citizenship. *Accord* 28 U.S.C. § 1332. Merit filed third-party complaints against VTA, Taber's inspecting architect, asserting that they conspired with Taber to officially deny substantial completion of the projects, and Desarrollos, the subcontractor hired to build the basic structures, asserting that it is entitled to indemnification under the subcontract agreement for any damages sustained by Taber as a result of Desarrollos' improper construction.[1]

Desarrollos and VTA seek dismissal of this action on grounds that this Court is without subject matter jurisdiction because diversity of citizenship between Merit

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[1] Defendant Insurance Company of North America ("INA") furnished to Taber a Performance Bond to guarantee Merit's faithful performance of its obligations pursuant to the contract between Taber and Merit for the construction of a new hotel tower.

and Taber does not exist. These motions were filed on the eve of trial, after months of extended and costly discovery; however, Rule 12(h)(3) of the Federal Rules of Civil Procedure provides that "[*w*]*henever* it appears by suggestion of the parties or otherwise that the court lacks jurisdiction over the subject matter, the court shall dismiss the action" (emphasis added). *Cf.* Rule 12(c) (other non-waivable jurisdictional defenses may be brought to the court's attention after the time for filing motions to dismiss has passed by way of a motion for judgment on the pleadings, but such motion must be made "within such time as not to delay the trial.") The motions have been opposed by both the plaintiff *and* the defendant, who argue that diversity exists between them; however, as Judge Selya noted in a similar context, "subject matter jurisdiction is a bit like pregnancy; it either exists or it does not. If the latter, jurisdiction cannot be conferred by agreement or concession of the parties." *Northeast Federal Credit Union v. Neves,* 837 F.2d 531, 532 n.2 (1st Cir. 1988) (citations omitted). Given the complicated issues presented on these motions, the Court finds it unfortunate that Judge Selya's colorful analogy cannot be extended so that the Court might, instead of having to sift through these difficult issues, simply wait nine months to see how everything turns out.

The material facts underlying the jurisdictional issues raised by movants are not in dispute. In 1986, Mr. F. Eugene Romano and Ms. Linda E. Romano, both citizens of New York, incorporated Lerfer and Calumet in New York. Mr. Romano owns all the outstanding shares of Lerfer, in exchange for which he paid $479,300.00. He acts as its president and treasurer. Ms. Romano owns all the outstanding shares of Calumet, in exchange for which she paid $300.00. She acts as its president and treasurer. The directors of both Lerfer and Calumet are Mr. Romano, Ms. Romano, and Mrs. Jeanne Romano. Mrs. Jeanne Romano serves as secretary for both corporations.

Both Lerfer and Calumet are Subchapter S corporations under 26 U.S.C. § 1361 and New York Tax Law § 660 (a) (McKinney's 1987). Both have their headquarters at 501 Main Street, Utica, New York. Both file federal income tax returns from New York and state income tax returns in New York. Neither files income tax returns from or in Puerto Rico.[2] Both maintain their corporate books in New York. Both have entered into contracts establishing bank accounts, lending and borrowing money, and establishing working capital accounts in New York. The Certificates of Incorporation of both Lerfer and Calumet contain general declarations that their purpose is to engage in all lawful acts or activities under New York law.

Lerfer and Calumet entered into a partnership agreement that formed Taber. The agreement delegated operation of the partnership to an executive director, Mr. Romano, and an assistant director, Ms. Romano. It also granted the partnership the authority to borrow money, enter into contracts and "do any and all other acts necessary or proper in the furtherance of the partnership busi-

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[2] The laws of Puerto Rico view Taber as "special partnership" under the Special Partnership provisions of Supplement P of the Puerto Rico Income Tax Act of 1954 ("PRITA"), as amended by Act No. 8 of July 19, 1985. Pursuant to Supplement P of PRITA and the regulations thereunder, particularly Regulation No. 3369 dated November 4, 1986 (entitled "Amendment and Additions to the Regulations Pertaining to the Income Tax Act of 1954, as Amended, Approved on July 11, 1957, to Regulate All Relative to the Tax Treatment of Special Partnership and its Partners"), the partners of a special partnership are not considered or deemed to be doing business in Puerto Rico. As a result, neither Lerfer nor Calumet is required to file income tax returns in Puerto Rico.

Pursuant to a Resolution dated August 21, 1989, issued by the Governor of the Commonwealth of Puerto Rico, Taber enjoys a tax exempt status under the Puerto Rico Tourist Incentive Act of 1983, Act No. 52 of June 2, 1983, 23 L.P.R.A. § 693, *et seq.* Pursuant to 23 L.P.R.A. § 693c(b), Mr. Romano and Ms. Romano, as share-holders of Lerfer and Calumet, are considered separately as if they were the partners of Taber and are therefore also exempt from Puerto Rico tax.

ness." Agreement at § 4.04. Taber's business is the operation and management of the Ambassador Plaza.

## II. Discussion

### A. Controlling Legal Principles

District courts have original jurisdiction over all civil actions in which the amount in controversy exceeds $50,000.00 and the dispute is between "citizens of different States." 28 U.S.C. § 1332(a)(1). Once jurisdictional allegations are challenged, the party asserting diversity has the burden of establishing the allegations with competent proof. *Media Duplication Services v. HDG Software*, 928 F.2d 1228, 1235 (1st Cir. 1991) (citing *Thomson v. Gaskill*, 315 U.S. 442, 446 (1942); *Topp v. CompAir Inc.*, 814 F.2d 830, 839 (1st Cir. 1987); *de Walker v. Pueblo International, Inc.*, 569 F.2d 1169, 1172 n.4 (1st Cir. 1978)).

The Supreme Court has held that general partnerships, like Taber, as well as other types of unincorporated associations, are not "citizens" for purposes of jurisdiction under Section 1332. *Accord Great Southern Fire Proof Hotel Co. v. Jones*, 177 U.S. 449 (1900); *Chapman v. Barney*, 129 U.S. 677 (1889). To determine the citizenship of such entities for diversity purposes, the citizenship of their constituent partners or members must be consulted. *Accord Carden v. Arkoma Associates*, 494 U.S. 185, 195-96 (1990) (citations omitted) (". . . diversity jurisdiction in a suit by or against the [unincorporated] entity depends on the citizenship of 'all the members,' 'the several persons composing such association,' 'each of its members.' ") In this case, therefore, the citizenship of Taber can be established by considering the citizenship of Lerfer and Calumet.

Pursuant to 28 U.S.C. § 1332(c)(1), "a corporation shall be deemed to be a citizen of any State by which it has been incorporated and of the State where it has its principal place of business." *See also* 28 U.S.C. § 1332

(d) (the word "state" in Section 1332 includes the Commonwealth of Puerto Rico). The movants acknowledge that Lerfer and Calumet are incorporated in New York but argue that their principal place of business is in Puerto Rico, thereby establishing dual citizenship for both corporations and defeating diversity jurisdiction in this case. *See Chemical Transportation Corp. v. Metropolitan Petroleum Corp.*, 246 F. Supp. 563 (S.D.N.Y. 1964) (the purpose of Section 1332(c)(1), which gives dual, not alternative, citizenship to a corporation whose principal place of business is located in a state different from the state of its incorporation, is to restrict the diversity jurisdiction of the federal courts).

Several techniques can be used to establish the principal place of business of a corporation. In *Topp v. Compair Inc.*, 814 F.2d 830 (1st Cir. 1987), the First Circuit explained:

> This court has recognized that there are three distinct, but not necessarily inconsistent tests for determining a corporation's principal place of business. *de Walker v. Pueblo International, Inc.*, 569 F.2d 1169, (1st Cir. 1978). One is the "nerve center" test which searches for the location from where the activities of the corporation are controlled and directed, *Lugo-Vina v. Pueblo International, Inc.*, 574 F.2d 41, 43 (1st Cir. 1978). The other two tests are the "center of corporate activities" test, *i.e.*, where the corporation's day-to-day management takes place, *de Walker*, 569 F.2d at 1172; *Kelly v. United States Steel Corp.*, 284 F.2d 850, 854 (3d Cir. 1960); and the "locus of the operations of the corporation" test, *i.e.*, where the bulk of the corporation's actual physical operations are located, *Inland Rubber Corp. v. Triple A Tire Service, Inc.*, 220 F. Supp. 490 (S.D.N.Y. 1963) . . . .
>
> The nerve center test was developed in the context of corporations with "complex and farflung activities." *de Walker*, 569 F.2d at 1172. See *Scot Type-*

> *writer Co. v. Underwood Corp.*, 170 F. Supp. 862 *(S.D.N.Y. 1959)*. The nerve center is described as "the center of gravity . . . , the place where most of the higher officers mantained offices, where the policy decisions were made, where the administrative departments were located, and where the last income tax return has been filed." 1 *Moore's Federal Practice* ¶ 0.77[3.-2], at 717.67 (2d ed. 1986).
>
> In *Lugo-Vina* we acknowledge that the nerve center test may be appropriate in respect to a holding company, 574 F.2d at 43 n.2, because the test was developed for cases involving corporations with complex and farflung activities where only the nerve center can truly be termed the principal place of business. *Id.* at 43.

*Topp,* 814 F.2d at 834 (1st Cir. 1987); *see also id.* at 835 n.4 (emphasis in original) ("what is sought . . . is the operational center of the corporation in question, *giving proper regard to the corporate identity*").

Since *Topp,* a fourth test has emerged, the "total activities" test, which was developed by the Fifth Circuit and has been recognized in this district. *See, e.g., Zavala v. G.D. Searle & Co., Inc.*, Civil No. 90-1747 (PG), 1991 WL 128222 (citing *J.A. Olson Co. v. City of Winona,* 818 F.2d 401 (5th Cir. 1987)). The total activities test is "the union of the 'nerve center test' and the 'corporate activities test.'" *Id.* It takes each of the factors considered under these two tests into account, although different factors are given varying weight in different contexts. The total activities test thus operates based on a series of guidelines:

> (1) when considering a corporation whose operations are far flung, the sole nerve center of that corporation is more significant in determining principle place of business; (2) when a corporation has its sole operation in one state and executive offices in another, the place of activity is regarded as more significant; but (3) when the activity of a corpora-

> tion is passive and the "brain" of the corporation is in another state, the situs of the corporation's "brain" is given greater significance . . . .

*J.A. Olson*, 818 F.2d at 411 (citations omitted).

B. Subchapter S Corporations

Before applying these tests to Lerfer and Calumet, one must understand the effect of their status as Subchapter S corporations. This requires an understanding of the nature and purposes of Subchapter S corporations.

In 1958, Congress established the Subchapter S corporation to provide taxpayers with a vehicle to obtain the financial benefits of a corporation without bearing the costs of double taxation. *Accord* Sommerfeld, Anderson & Brock, *An Introduction to Taxation* at 11-8 (1983 ed.). The result is "a tax hybrid—part corporation, part partnership." *Id.* In a S corporation, a conduit system allows profits to flow through the corporate entity so that shareholders report the corporation's taxable income or loss on their individual tax returns in a manner similar to that of partnerships and partners. Traum & Traum, *The S Corporation Answer Book* at 1 (1988). As a result, earnings are not taxed as income at the corporate level. Instead, they are taxed only on the distribution to shareholders, who pay taxes on a pro rata share of the entity's income. This elimination of double taxation is perhaps the greatest advantage of the S corporation over a regular or "C" corporation.[3]

To be eligible to make an S corporation election, a corporation must be a "small business corporation"—that is, it must have (i) no more than 35 shareholders; (ii)

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[3] Other advantages include avoidance of the corporate alternative minimum tax provisions, possible avoidance of the limitation on passive losses, and avoidance of the accumulated earnings tax. Fass & Gerrard, *The S Corporation Handbook* §§ 1.01[3]-1.01[5] (1991-92 ed.).

shareholders who are either individuals, estates, or certain types of trusts; (iii) no nonresident alien as a shareholder; and (iv) no more than one class of stock. 26 U.S.C. § 1361(b)(1). It must also be a domestic corporation that is not otherwise "ineligible." I.R.S. Prop. Reg. § 1.1261-1A(c) (Oct. 7, 1986) (ineligible corporations include those that are members of affiliated groups, certain financial institutions, certain insurance companies, corporations to which an election under Section 936 concerning Puerto Rico and possession tax credits applies, and domestic international sales corporations). A corporation's S status will be lost if any of these limitations are violated or if its passive investment income exceeds 25 percent of gross receipts for three consecutive taxable years and it has subchapter C earnings and profits. 26 U.S.C. § 1362(d)(3).

In addition to the advantages of an S corporation over a C corporation,[4] the form also has various advantages over a partnership. For example, it can provide an opportunity for participation in management to all investors, which is denied to limited partners seeking to protect their limited liability status. Its shares can be freely transferred. It has an unlimited continuity of life. And the liability of all investors is limited, not just that of limited partners. Fass & Gerrard, *The S Corporation Handbook* § 3.01[2] (1991-92 ed.) These advantages have generated increasing interest in the use of the S corporation form either as an alternative to C corporations and partnerships or with other entities to achieve the desired blend of limited liability, participation in management, allocation of tax attributes, and single-level taxation on earnings. *Id.* § 1.01[6]. In 1985, approximately 75,000 S corporation

[4] One disadvantage that S corporations have in comparison to C corporations is the reduced availability of fringe benefits. In dealing with such benefits, S corporations are treated like partnerships with any shareholder who owns more than 2 percent of the stock treated as a partner. As a result, these expenses are not deductible at the corporate level. *Id.* § 3.02[7][a].

elections were made. For 1992, the IRS projects that almost 1,014,000 S returns will be filed, representing 22 percent of the projected corporate returns for the year. *Id.* § 1.01.

One effective way in which to use an S corporation is as the plaintiffs have—in conjunction with a limited partnership. One commentator has explained:

> It appears that an S corporation as a general partner in a limited partnership, *or several S corporations in partnership,* can be effectively utilized to overcome the disadvantages inherent in the limited partnership and S corporation entities when taken individually. For example, these arrangements can: produce limited liability for all members of the partnership; provide special allocations among investors; accommodate later break-up or separation of the business; protect S corporations from the tax on excess passive investment income; allow for otherwise impermissible investors (e.g., nonresident aliens and certain trusts); escape the passive loss limitation rules; and plan for estate freeze potential.

*Id.* § 3.04 (emphasis added).

C. Views of the Parties

The bedrock assertion of both Taber and Merit is that the only "business activity" of Lerfer and Calumet—which they allege were incorporated for the purpose of acting as subchapter S corporations and mere investment vehicles—is to administer and hold their respective interests in Taber, which administration consists of monitoring the records, accounts, and finances of the corporations —activities which occur exclusively in New York. They contend that Taber's activities are irrelevant to the determination of the principal place of business of Lerfer and Calumet and that "the correct inquiry focuses on Lerfer and Calumet and their principal places of business as holding companies, rather than the alleged activities of

Taber." Plaintiff's Memorandum of Law at 12. They assert based on this narrow view of the operations of Lerfer and Calumet that the corporations must be viewed as having their principal places of business in New York.[5]

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[5] Taber and Merit differ somewhat as to how the tests set forth in Part II.A. should be applied to yield such a conclusion. Taber argues that the nerve center test alone is controlling in this case and that application of any other test to holding companies like Calumet and Lerfer would contravene the directives of the First Circuit in *Topp*. Taber asserts that despite suggestions that application of the nerve center test is confined to companies with "far flung" operations, the test is appropriately applied to corporations engaged in "passive activity that—unlike manufacturing, buying and selling—provides for negligible contact with the public." 1 *Moore's Federal Practice* ¶ 0.77[3.-2] (2d ed. 1992). Applying the factors set forth in *Topp* for determining the nerve center of a corporation (*accord* 814 F.2d at 830), Taber argues that since it is in New York that (i) the corporate headquarters of both Calumet and Lerfer are located, (ii) both corporations file their tax returns, (iii) their corporate records and bank accounts are located, (iv) personnel who administer the corporations are located, and (v) meetings of their boards of directors are held, New York must be considered the principal place of business of both corporations.

Merit, on the other hand, believes that the nerve center test operating independently is more appropriately applied to large corporations with far-flung activities. It also believes that the locus of operations test is inapplicable to Lerfer and Calumet because it focuses on the place where the bulk of the corporation's actual physical operations are located and Lerfer and Calumet have no physical operations. Merit argues that the corporate activities test *could* be applied to Calumet and Lerfer—and if applied would point to New York as the "headquarters of day-to-day corporate activity and management" (*Kelly v. United States Steel Corp.*, 284 F.2d 850, 854 (3d Cir. 1960)) of both corporations—but feels that this test alone is not sufficient in analyzing the principal place of business of Lerfer and Calumet. Merit asserts instead that the total activities test should be applied in this case. Merit then argues that all three of the total activities factors point to New York as the principal place of business of both corporations: the nerve center of both corporations is in New York; the "activities" of both corporations occur in New York since their only function is to act as S corporations for Mr. and Ms. Romano; and the situs of the

Desarrollos and VTA respond that in reality the "business" of both Lerfer and Calumet is the management and operation of the Ambassador Plaza. They assert that the only business purpose of both corporations is the administration of their respective interests in the Ambassador Plaza, which is the only real asset of both corporations as well as their most substantial investment. They then attempt to impute to the corporations all of the activities of the partnership in Puerto Rico, which are substantial. Based on this analysis, they assert that the corporate purpose of both Lerfer and Calumet is therefore fulfilled in Puerto Rico.[6]

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"brain" of both corporations is in New York. Merit contends that this last factor should be considered more significant since Calumet and Lerfer are primarily involved in passive investment.

[6] Desarrollos, for reasons similar to those of Merit, asserts that the total activities test should be applied to resolve this issue. Unlike Merit, however, Desarrollos suggests that the Court should follow guideline two of the test and give primary weight to the place of activity of Lerfer and Calumet. Desarrollos brings forth a long list of facts which support its characterization of the business of both corporations and its assertion that the corporate purpose of both corporations is fulfilled in Puerto Rico. Most of these facts are intended to show that the business of the corporations and the partnership is indistinguishable. For example, the purpose of incorporating both corporations was to serve as owners of the Ambassador Plaza; the corporations are co-owners of the Ambassador Plaza property; and the shareholders of the corporations are the managers of the partnership. The other facts set forth by Desarrollos indicate more directly that the primary business of the corporations has occurred in Puerto Rico. For example, the two major transactions which the corporations have entered into have been (i) to authorize the formation of Taber through a meeting of its board of directors in San Juan and (ii) to authorize Taber to execute a Bond Purchase Agreement, Loan Agreement, and Letter of Credit Agreement to obtain AFICA financing in the amount of $27,650,000.00 through a meeting which also occurred in San Juan. Desarrollos then concludes that since Taber's single operating activity occurs in Puerto Rico, the principal place of business of both Lerfer and Calumet is also Puerto Rico.

VTA's contentions are virtually identical to those of Desarrollos.

D. Preliminary Considerations

The Court must determine the nature of the relationship between Lerfer and Calumet on the one hand and Taber on the other. This is a difficult task. Before tackling it, the Court pauses to set forth a few preliminary considerations.

First, the Court rejects outright the narrow view of Lerfer and Calumet suggested by Merit and Taber. They consistently refer to the entities as "subchapter S corporations' as though this designation conclusively defines the contours of their business and purposes; however, viewed in this narrow fashion, there are no such creatures as "subchapter S corporations." Instead, there are only corporations which have made an *election* under subchapter S of the Internal Revenue Code to receive certain tax treatments. As seen in Part II.B. of this Opinion, this election only affects a corporation's and shareholder's tax liability; it does not alter the fundamental business of a corporation. *Accord* 1 C. Keating & G. O'Gradney, *Fletcher Cyclopedia of the Law of Private Corporations* § 36 at 576 (1990 rev'd vol.) (citing *Hadden v. City of Gatlinburg*, 746 S.W.2d 687 (Tenn. 1988)). The Court therefore rejects the notion that the *only* business purpose of Lerfer and Calumet is to administer and hold their respective interests in Taber.

The Court is tempted to resolve this matter based solely on this conclusion. Lerfer and Calumet were incorporated to assist the Romanos in purchasing and controlling the Ambassador Plaza. Taber and Merit have attempted to sever this purpose from the corporations by pointing to the partnership that the corporations subsequently formed —whose day-to-day responsibilities involve the management of the hotel—and claiming that the partnership is a wholly distinct entity whose activities cannot be attributed to the partner corporations—which in turn would not exist absent the activities of the partnership. It cannot be denied that the *sine qua non* of the corporations is the operation of the hotel. Such is Desarrollos' view of

this issue. The Court, however, is uncomfortable with such a disposition for the following reasons.

Subchapter S corporations like Lerfer and Calumet are legitimate creations provided for by federal and state law. In addition, the partnership created between the two corporations is a legitimate venture. The Romanos' purpose in structuring its business using these entities was to avail itself of tax and liability advantages provided for by law—not to manipulate citizenship for purposes of diversity jurisdiction. If a by-product of the structure chosen is that a straightforward application of controlling caselaw suggests that federal jurisdiction lies in this case, perhaps the Court should ignore its other concerns. Such is Merit's and Taber's view of the issue. The Court is equally uncomfortable with this conclusion, however, because for several reasons it is not possible to effectuate a straightforward application of controlling caselaw to this issue.

Considerations of the interrelationships between corporations, or between corporations and other related forms, cut across a series of related issues, including corporate liability, personal jurisdiction, and, as here, corporate citizenship. Moreover, although each of these issues requires consideration of a different group of factors, much of the ground overlaps. As Judge Selya has pointed out in the context of piercing the corporate veil, "[w]hile it is generally true that questions of '[l]iability and jurisdiction are independent,' the factors that we must consider . . . in the liability context also inform the jurisdictional inquiry." *United Electrical, Radio and Machine Workers of America v. 163 Pleasant Street Corp.*, slip op. no. 91-1824 at 24 (1st Cir. March 30, 1992) (hereinafter *UERMWA*) (citations omitted). More significantly, the tests used to determine the citizenship of corporations and partnerships, which can be difficult to apply in isolation, appear unhelpful where, as here, they must be applied simultaneously. The Court is therefore mindful of Judge

Selya's warning in another related context that in situations of this sort "the seductive appeal of rigid stratification must yield to a frank appraisal of the realities surrounding any given relationship." *Donatelli v. National Hockey League,* 893 F.2d 459, 468 (1st Cir. 1990).

E. Analysis

Having dispensed with these preliminary considerations, the Court finds that, because Lerfer and Calumet do not engage in complex and far-flung activities, the total activities test is most appropriately applied to determine their principal place of business. *Accord American/Caribbean Development, Inc. v. Lincoln American Corporation,* slip op. no. 90-2289 (PG) at 13-14 ("[Defendant] is not a company with 'complex and far-flung activities.' Therefore, neither the nerve center, the center of corporate activities nor the locus of operations tests seem appropriate tests to apply.") Of all of the established tests, only the total activities test provides a sufficiently realistic, flexible, and nonformalistic approach, which is necessary to effectuate an appropriate balancing of all the factors to be considered in this case. *See J.A. Olson, supra,* 818 F.2d at 412.

The Court therefore considers the dual prongs of the total activities test: nerve center and center of corporate activities. Applying the factors set forth by the First Circuit in *Topp,* the Court finds that the nerve center of both corporations is located in New York, since it is the location of their corporate headquarters, principal bank accounts, corporate records, and corporate personnel, as well as the state from which they file income tax returns and which they have designated in corporate documents as the location of their corporate headquarters. *Accord Topp, supra,* 814 F.2d at 837-38. Conversely, the Court finds, based on its conclusion that the dominant business of both Lerfer and Calumet is their interest in the Ambassador Plaza, that the center of corporate activities of both corporations is located in Puerto Rico.

The Court must therefore determine which of these two factors should be given more weight in this case under the guidelines set forth in *J.A. Olson*. Desarrollos contends that guideline two—when a corporation has its sole operation in one state and executive offices in another, the place of activity is regarded as more significant—controls. *Accord North Star Hotels v. Mid-City Hotel Associates*, 696 F. Supp. 1265 (D. Minn. 1988) (citing *Hanna Mining Co. v. Minnesota Power & Light Co.*, 573 F. Supp. 1395 (D. Minn. 1983), *aff'd*, 739 F.2d 1368 (8th Cir. 1984) ("when virtually all of the corporate business is conducted in one state but the headquarters and corporate-policymaking functions are located in another, the situs of the corporate business assumes greater importance.") Merit contends that guideline three—when the activity of the corporation is passive and the brain of the corporation is in another state, the situs of the corporation's brain is given greater significance—controls.[7]

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[7] Merit directs the Court's attention to *Village Fair Shopping Center v. Sam Broadhead Trust*, 588 F.2d 431 (5th Cir. 1979), which involved a similar dispute and was decided by resort to guideline three. Plaintiff sought a declaratory judgment in federal court regarding amounts due under certain lease agreements. Defendants challenged plaintiff's allegation of diversity of citizenship, arguing that Mississippi was the principal place of business of M.L. Enterprises, Inc., a partner in the plaintiff company, a consortium operating the Village Fair Shopping Center in Lauderdale County, Mississippi. The undisputed evidence showed that M.L. Enterprises was a real estate and general trading company incorporated in Delaware with its only office in New York. Both officers of the corporation, and two of its three shareholders, resided in New York. The corporation had no salaried employees. At the time of the lawsuit, the corporation had only three investments: $250,000.00 in the Mississippi shopping center; $125,000.00 in a shopping center in California; and $400,000.00 in short-term commercial paper and bank accounts in New York. All decisions on behalf of the corporation were made in New York. New York was designated as the corporation's principal place of business for tax purposes. And, aside from its interest in the shopping center,

The Court accepts Desarrollos' contention and applies guideline two. For the same reasons set forth in Part II.B of this Opinion, the Court rejects the contention of

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the corporation's only other contact with Mississippi was the fact that it was qualified to do business in the state.

The trial court found that despite the fact the corporation's business was conducted in New York, "its activities [were] actually motivated by the ultimate accomplishment of its largest single tangible property in Lauderdale County, Mississippi." 588 F.2d at 433. The circuit court, which did not question the trial court's methodology, nonetheless rejected its conclusion about the interests of the corporation. The court explained:

> The corporation is obviously interested in its single largest equity investment; however, there is no evidence to show that this property requires even a proportionate share of the attention of the corporate affairs. Since the property was purchased, the officers have paid almost no attention to it.
>
> In contrast, the activity in New York is far more significant and is thus determinative of the corporation's principal place of business. For no apparent reason, the trial court discounted the sizable assets held by the corporation in New York in the form of short-term commercial paper and bank accounts. While it is true that the largest single piece of realty owned by the corporation is the Mississippi shopping center, the tangible assets in New York have greater aggregate value than the Mississippi property. In addition, the trial court failed to give any weight to the frequent activity occurring exclusively in New York in connection with the management and investment of the short-term commercial paper . . . . The single passive investment in the Mississippi shopping center should not of itself outweighed all of the other factors we have mentioned in the determination of the company's principal place of business.

*Id.* at 434 (citations omitted). Merit contends that this case is directly on point and dictates a similar conclusion that the single passive investment of Lerfer and Calumet in Puerto Rico cannot outweigh all of the factors indicating that the principal place of business of the two corporations is New York.

The Court rejects Merit's contention. The only connection that either Lerfer or Calumet has in New York, aside from matters relating to corporate formalities, are bank accounts and working capital accounts maintained in New York. In contrast to *Village Fair*, in which similar accounts constituted a significant part of

Merit and Taber that Lerfer and Calumet are only engaged in passive investment activity. Only a unrealistically narrow view of the orientation of the corporations and their partnership could yield such a conclusion. The corporations were formed to act as owners of the Ambassador Plaza. They devote almost all of their corporate activity to administer their assets in the partnership. They actively authorized the formation of Taber and the obtaining of a bond to assist in the financing of the projects. They have loaned substantial amounts of money to Taber. And the directors of the partnership, Mr. and Ms. Romano, are the directors of the corporations. Under these circumstances, the Court cannot accept the characterization of the corporations' interests in Taber as passive. The Court therefore considers of greater significance the location of the corporations' primary activity. This activity is the renovation and operation of the Ambassador Plaza, which is located in Puerto Rico.

III. Conclusion

The Court thus finds that the principal place of business of both Lerfer and Calumet is in Puerto Rico; that the domicile of Taber is located in Puerto Rico; that diversity of citizenship does not exist in this case; that the motions to dismiss filed by Desarrollos and VTA must be GRANTED; and that this case must be DISMISSED for lack of subject matter jurisdiction pursuant to Rule 12(h)(3) of the Federal Rules of Civil Procedure.

IT IS SO ORDERED.

In San Juan, Puerto Rico, this 7 day of July, 1992.

/s/ Jaime Pieras, Jr.
JAIME PIERAS, JR.
U.S. District Judge

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the corporation's investment activity, in this case the accounts maintained by Lerfer and Calumet are dwarfed by their respective interests in Taber. *See, supra,* note 6.

**APPENDIX C**

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

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No. 92-1921

TABER PARTNERS, I, A NEW YORK GENERAL PARTNERSHIP,
*Plaintiff, Appellant,*

v.

MERIT BUILDERS, INC., A PUERTO RICO CORP, *et al.*,
*Defendants, Appellees,*

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No. 92-1922

TABER PARTNERS, I, A NEW YORK GENERAL PARTNERSHIP,
*Plaintiff, Appellee,*

v.

MERIT BUILDERS, INC., A PUERTO RICO CORP.,
*Defendant, Appellant.*

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Before
Selya, *Circuit Judge,*
Coffin, *Senior Circuit Judge,*
and Stahl, *Circuit Judge.*

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# CORRECTED ORDER OF COURT

Entered: April 2, 1993

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Upon consideration of the petitions for rehearing filed by Desarrollos Metropolitanos, Inc., and Victor Torres and Associates,

It is ordered that both petitions for rehearing be denied.

By the Court,

/s/ Francis P. Scigliano
FRANCIS P. SCIGLIANO
Clerk